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No. 06-837

IN THE

Supreme Court of the United States

OLD STONE CORPORATION,
Petitioner,

v.

UNITED STATES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Both the Petition and the supporting *amicus* brief filed by the U.S. Chamber of Commerce demonstrate that the Federal Circuit has severely and improperly curtailed the important remedy of restitution for government contractors that are victims of a material Government breach of contract. In its decision, the Federal Circuit first expanded the "election of remedies" doctrine to bar restitution of invested money, as a matter of law, based not on the breach victim's demand for or receipt of any further post-breach contract performance from the Government, but on the victim's reasonable efforts to save the enterprise and thus mitigate, or even eliminate, the damage. The Federal Circuit then further restricted restitution by barring restoration of the parties to their pre-contract situation as a "windfall" if doing so would make the breach victim better off than if the contract had been performed. This Court should review those two rulings, because their adverse effect extends far beyond the *Winstar* context to Government contracting generally, and they conflict with *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604 (2000), with various circuit-court decisions, and with basic principles of contract remedies, as the Petition and the Chamber's *amicus* brief explain.

The Government's brief in opposition offers no sound reason for withholding review. Despite its efforts, the Government cannot square either of the Federal Circuit's two rulings with *Mobil Oil* or with the consistent pronouncements and practices of other courts on both the election and windfall issues. In fact, the Government's discussion joins the two issues and loudly confirms the extraordinary proposition underlying, and now established by, the Federal Circuit's decision—that reasonable, commendable efforts at mitigation by a victim of a total Government breach forfeit the restitution remedy. That harmful and dramatic result warrants certiorari to prevent penalizing mitigation efforts, even Gov-

ernment-compelled ones, and to reinstate the simple remedy of restoring amounts invested under a contract that the Government has materially breached.

A. Election of Remedies

1. The Petition shows that the Federal Circuit improperly found an election of remedies even though Old Stone did not receive, or even seek, the "significant postrepudiation performance" of the breached contract by the Government that *Mobil Oil* requires for loss of the restitution remedy. 530 U.S. at 623. The Government, in response (Opp. 10-11 & n.1), makes the bold assertion that the court of appeals actually *did* find such performance, relying on the Federal Circuit's reference to "continued benefits to [Old Stone] received under the earlier agreements" (Pet. App. 19a, quoted Opp. 10)—"benefits" amounting to Old Stone's post-breach operation of the thrift it was trying to save. But that is simply mistaken for at least one fundamental reason: continued holding of a benefit received in the *past* is not the same as receiving "significant *postrepudiation performance*" by the breaching party. *Mobil Oil*, 530 U.S. at 623 (emphasis added). And here the two are plainly distinct, because it is undisputed that the Government had no performance obligations left in 1989 except for the one that FIRREA irrevocably breached. *See* Pet. 3. The Federal Circuit, in relying on the "benefits" "under the *earlier* agreements" (Pet. App. 19a (emphasis added)), at best confused such benefits with post-breach Government performance. It did not and could not find the required post-breach Government performance.[1]

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[1] The Government, in its one-paragraph discussion of the "benefits," conspicuously does *not* say that those benefits embodied its performance of any post-breach contractual obligation. Opp. 10-11.

Even the premise of temporarily retained "benefits," moreover, is mistaken: *e.g.*, the post-breach operation was under regulatory compulsion, as the trial court found (Pet. 3-4, 17-18); there was no "benefit" to Old Stone

The distinction between temporary retention of previously conferred benefits and receipt of new post-breach performance is both plain on its face and critical for a number of reasons. Most striking, perhaps, is the practical impact of disregarding the distinction. Holding onto benefits received in the past will be the normal course during a Government contractor's efforts to mitigate harm caused by a material breach: the breach victim can hardly try to save the enterprise, and thus mitigate damages, without retaining and operating it. If temporarily retaining past benefits is confused with accepting post-breach performance from the breaching party, and deemed sufficient for an "election of remedies," typical mitigation efforts by government contractors will result in forfeiture of the restitution remedy, and such efforts therefore will be powerfully discouraged. The Federal Circuit's decision, in its expressed basis for finding an election, thus means that essentially any post-breach mitigation efforts (even if reasonable, as required by law and found here, and even if compelled, as found here) will forfeit restitution. That is why the Federal Circuit's decision is so broad. And its breadth is confirmed by the Chamber of Commerce's support for certiorari because of the decision's harmful impact across the full spectrum of Government contracting.

Doctrinally, the breach victim's continued holding of past benefits during mitigation efforts is and must be kept distinct from post-breach performance by the contracting party: only the latter, not the former, can trigger an "election of remedies" bar.[2] The Government cites not a single decision find-

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of owning the larger institutions (by acquiring the troubled thrifts) *without* the regulatory-capital promise later breached by FIRREA (Old Stone rejected such a deal before acceding to the Government's solicitation for help with the troubled thrifts, Pet. 2); and Old Stone always made separate *payments* for the deposit insurance.

[2] Restitution requires subtracting or returning such benefits, of course, but that is not an issue here. Well before any award of restitution, the

ing an election based on use of past benefits during mitigation, and for good reason. As the Chamber of Commerce explains, one essential precondition to an "election" loss of the restitution remedy is that the action taken be "inconsistent" with restitution, but mitigation efforts (by operating the enterprise) are entirely consistent with the remedy of returning the original investment if the mitigation efforts fail. Chamber *Amicus* Br. 18-19; *see also id.* at 12-13 (new Restatement permits both restitution of amounts invested and "incidental damages," one common label for mitigation damages). A proper inconsistency inquiry necessarily has a *forward*-looking focus—looking to the breach victim's demand for and receipt of *future* performance of that contract from the breaching party. *Id.* at 16-17.

Contrary to the Government's argument (Opp. 12-13), that is just what this Court's decision in *Mobil Oil* established. The Government treats *Mobil Oil* as involving a government contractor that did not continue any contract activities of its own after breach and thus tries to limit to that situation *Mobil Oil*'s clearly stated, and pervasively relied-on, requirement of "significant postrepudiation performance" by the breaching party as a precondition for loss of the restitution right (530 U.S. at 623; *see* Pet. 13-15). But that treatment misreads *Mobil Oil*, which recognized that the breach victim did engage in "continued actions under the contracts" (530 U.S. at 622) and made "'efforts of its own to fulfill the conditions' of the contract" (*id.*). The Court's point in *Mobil Oil* thus was not, and could not have been, that the breach victim engaged in no post-breach performance, but that, for waiver purposes, such performance legally could not matter. It could

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Government had seized the bank, taking all the assets (including the investments Old Stone had made); and the Federal Circuit nowhere disputed the trial court's specific finding that the Government had *not* proved the existence of any benefits to be offset against the restitution award. *See* Pet. 5; Pet. App. 90a, 92a-93a.

not "amount to anything more than urging performance" by the Government after breach—a breach victim's "urging performance and making 'efforts of its own to fulfill the conditions' of the contract come to the same thing"—and what matters is whether "the [plaintiffs] *received* at least partial performance" after breach. *Id.*

Nothing in the text or logic of *Mobil Oil* supports limiting its requirement of post-breach performance by the breaching party to situations where the breach victim has not taken any contract-related action of its own after breach. The Government, though declaring that *Mobil Oil* is so limited, offers no explanation whatever for why such a limitation makes sense. The Federal Circuit, for its part, misunderstood *Mobil Oil*, disregarding what it said about the threshold "inconsistency" requirement for election (a requirement the Federal Circuit apparently just overlooked) and focusing only on the secondary requirement of "detrimental reliance." *See* Pet. App. 17a-18a; Pet. 13, 15. The Federal Circuit's dramatic transformation of the law of *Mobil Oil* should not be allowed to stand without this Court's review. *Mobil Oil* cannot be distinguished, as the Government urges, based on a limitation that the Government never justifies and that is incompatible with the text of this Court's decision.

With respect to the Federal Circuit's finding of "detrimental reliance," the Government's defense (Opp. 11-12) could not save the Federal Circuit's ruling even if it were correct: the failure of the threshold inconsistency requirement makes detrimental reliance immaterial. Moreover, while the Government says that one form of detrimental reliance was the post-breach infusion of $74.5 million (Opp. 11), it does not and cannot explain how that action by Old Stone could itself be detrimental reliance *by the Government*. The Government accordingly must point to the Federal Circuit's observation that delaying seizure, while Old Stone infused money and tried to save the thrift, "likely" caused greater losses to the

Government. Pet. App. 19a; Opp. 11-12. But this cannot constitute detrimental reliance for at least two reasons. First, Old Stone's investment was exactly what the Government itself sought: the Government concedes that it "requested" that investment (Opp. 11); and that is a gross understatement, for the undisturbed findings by the trial court are that the Government exercised its regulatory authority to *require* the investment. Pet. 17-18. *See* Chamber *Amicus* Br. 20 ("Refraining from seizing the failed thrift was not reliance at all; it was precisely the course the Government wanted to pursue anyway."). Second, the assertion of "likely" harm to the Government from postponing seizure is nothing but an improper, unsupported appellate factual finding that directly contradicts the findings of the trial court, the authorized finder of facts. *See* Pet. 18-19.[3]

2. The Government seeks to diminish the significance of the Federal Circuit decision's departures from other decisions. Opp. 14-16. Notably, however, the Government advances no supporting case law of its own. And it cannot deny that the decision below upsets previously clear understandings and practices.

Even if the focus were solely within the Federal Circuit, deep disharmony either about the governing legal principles or about practices in comparable cases would justify intervention by this Court, given the Federal Circuit's unique appellate authority over government contracts—despite the endless opportunities that typically complex fact patterns offer for distinguishing cases on their facts.[4] Here, as the

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[3] The Government nowhere disputes the Petition's showing that "risk-based capital shortfall" does not measure increased losses upon seizure. *See* Pet. 19 n.8.

[4] For such reasons, this Court has granted review in patent-law cases based in part on internal Federal Circuit disparities in legal pronouncements. *E.g.*, *KSR Int'l Co. v. Teleflex, Inc.*, No. 04-1350, oral argument

Petition explains (at 21-22), the Federal Circuit's clear statement of the law in *First Nationwide Bank v. United States*, 431 F.3d 1342, 1352 (Fed. Cir. 2005)—which is both expressly and in substance a "restitution" case—sets forth law that is diametrically opposed to that set forth in this case (a point the Government all but acknowledges, Opp. 15 n.2). And, as the Petition also explains, restitution of invested amounts has in practice been an accepted remedy in *Winstar* cases despite post-breach operation of thrifts. Pet. 22.

In this government contract case, two appellate decisions from outside the Federal Circuit conflict with the decision below and make its departure from accepted principles particularly worthy of review. In *Far West Federal Bank, SB v. United States*, 119 F.3d 1358 (Fed. Cir. 1997), the Ninth Circuit awarded restitution and rejected an election-of-remedies defense even after the thrift owners had aggressively demanded post-breach performance by the Government—by suing for an injunction—and continued operating the thrift for several years. And in *RTC v. FSLIC*, 25 F.3d 1493 (10th Cir. 1994), the Tenth Circuit likewise awarded restitution despite post-breach operation of the thrift. Those rulings cannot be fairly reconciled in principle with the law stated and applied by the Federal Circuit here.

Moreover, both *Far West* and *RTC* confirm the specific error of the Federal Circuit in finding an election despite the compelled nature of the post-breach efforts by Old Stone here. In *Far West* and *RTC*, the Government refused to permit the thrift owners to turn in their thrifts (Pet. 18), as the Government admits with respect to the *RTC* case (Opp. 16). Those decisions confirm that, while the Government may at least once have allowed a thrift owner to liquidate (Opp. 21), sometimes (indeed often) it did not. It is a factual question

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held Nov. 28, 2006; *Pfaff v. Wells Elecs.*, 525 U.S. 55 (1998); *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.*, 520 U.S. 17 (1997).

whether, in a particular situation, a thrift owner had a genuine option to turn in the keys; and in this case, the Government can do nothing but nakedly deny (Opp. 21), without giving any basis whatever for undermining, the trial court's pointed findings that Old Stone had no such option. *See* Pet. 17-18. Without that option, there can be no "election," *see* Chamber *Amicus* Br. 17-18, yet the Federal Circuit held that there was, as a matter of law. That ruling not only is incorrect but broadly threatens a large range of Government contractors, many of whom operate under Government regulatory authority. *See id.* at 5-7.

3. Finally, the Government briefly tries to respond to the harmful policy consequence of what it recognizes to be the broad import of the decision below, namely, that even reasonable mitigation efforts forfeit restitution. Opp. 21-22. The Government reiterates the Federal Circuit's suggestion that its rule averts the "moral hazard" of unjustified mitigation. *Id.*; Pet. App. 19a-20a. The conclusive answer is set forth in the Petition (at 17) and confirmed by the Chamber's *amicus* brief (at 19), but wholly ignored by the Government: the independent legal requirement that mitigation efforts be "reasonable" (as the Federal Circuit found they were here) already controls the hazard. With that control in place, the necessary effect of the Federal Circuit's broad decision is to discourage *reasonable* mitigation efforts by penalizing them with forfeiture of restitution of the original investment—which may, of course, be vastly greater than any mitigation costs, leading a contractor to avoid even easy, obviously commendable mitigation efforts. The Government says nothing to deny or to justify the harmful effects of discouraging efforts that can, and often do, benefit the contractor and Government alike. Review is warranted because the Federal Circuit's election-of-remedies ruling inherently penalizes such beneficial efforts.

B. Windfall

In addition to its election-of-remedies ruling, the Federal Circuit rendered a one-paragraph "windfall" ruling, saying that return of the original investment to Old Stone would be excessive. Strikingly, the Government has now made clear that this secondary ruling cannot stand alone, but is firmly tied to the election-of-remedies ruling. Opp. 17-20.

The Government offers *no* independent defense of the Federal Circuit's invocation, for restitution, of the proposition that "'the non-breaching party should not be placed in a better position through the award of damages than if there had been no breach.'" Pet. App. 27a. The Federal Circuit's express application of that notion to restitution thus is tacitly conceded to be error. And the legal issue is squarely presented and critical here, unlike in *Southwest Inv. Co. v. United States*, 126 S. Ct. 2321 (2006) (denying certiorari), *see* Opp. 18, which involved a non-precedential Federal Circuit decision summarily affirming the trial court's (rare) finding that *the breach was not material*, making the windfall ruling of no consequence.[5]

The Government's only defense of the Federal Circuit's "windfall" ruling is its assertion that the return of the original investment in addition to the return of the post-breach infusion "would give petitioner a double recovery." Opp. 18. The Government cannot mean that literally. The two amounts were separately invested "'actual costs'" incurred by Old Stone (as the Federal Circuit recognized, Pet. App. 10a), and it is "absurd on its face" to suggest that returning both of these investments is a double recovery. Chamber *Amicus* Br. 16 n.5.

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[5] *See Southwest Inv. Co. v. United States*, 158 Fed. Appx. 283 (Fed. Cir. 2005); 05-1087 Br. in Opp. for United States, 2006 WL 1139457, at 9-12.

All the Government must mean, therefore, is that there is some inconsistency between returning the post-breach infusion of capital as mitigation damages and returning the original investment as restitution. Opp. 18. (That is the Government's sole basis for distinguishing of *Mobil Oil* and all the other authorities invoked by the Petition. Opp. 18-20.) But that suggestion is nothing but a repetition of its election-of-remedies theory that mitigation efforts are inconsistent with restitution. That theory is as wrong when given a "windfall" label as when given an "election" label: in particular, recovery of mitigation expenses is not dependent on claiming any expectation of profits from future performance. And, regardless of the label, the theory is equally dangerous in punishing and thus deterring reasonable mitigation efforts. Whether that result should stand is, the Government's brief confirms, the issue at the heart of both questions presented in the Petition.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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